THE FARMER'S INTEREST IN OUR NATIONAL ECONOMY

Remarks by Chas. N. Shepardson, Member, Board of Governors, Federal Reserve System, before the Farm and Home Week Assembly, Agricultural Extension, University Station, at Baton Rouge, Louisiana, on August 15, 1956.

The topic I have chosen to discuss may be approached from two angles. We may consider the farmer's interest in our national economy from the standpoint of his share in the total or from the standpoint of his concern for the total economy. I propose to look at it from both angles because I think both are important to an understanding of our present situation in agriculture and in the economy as a whole.

Let us consider the broad picture first. Our national economy is running at the highest level in history. Our gross national product, which includes public and private consumption expenditures plus private domestic investment, last year reached a level of 391 billion dollars and is now running at a rate of nearly 410 billion dollars a year. Currently, income at over 340 billion dollars and total civilian employment at over 65 million are also record levels. While there are some soft spots in the economy, the country as a whole is operating at near capacity levels.

In fact, the spirit of exuberance which pervades most segments of the economy has generated a terrific consumer demand for goods and services. Coupled with the optimistic plans by business for plant and equipment expansion, this is putting a mounting pressure on productive capacity and is being reflected by a swelling wage price spiral. The effect of demand pressure on industrial commodity prices was evident last year, but then it was largely

offset by a continuing decline in farm prices with the result that the wholesale price index showed little change from that of 1953 and 1954. Since the upturn in farm prices from the low of last winter, this offsetting effect has decreased with the result that the general price index has started to rise in recent months, reflecting the inflationary effect of heavy demand pressure on available capacity and encouraging business management to bid aggressively for scarce labor even at the price of wage increased in excess of increased productivity.

Increased productivity is a principal key to our established pattern of economic growth. Our standard of living, either as individuals or as a nation, depends primarily on the amount of usable goods or services which we produce per man-hour of human labor. It is also dependent, however, on the maintenance of an aggregate purchasing power which is kept in balance with available supply. This is best illustrated by the contrast between developments of the past few years and those of the 30's.

During the 30's we were bogged down by a financial collapse which resulted in an atmosphere of fear and uncertainty. The debacle of the late 20's and early 30's had shaken our confidence. Talk was rampant about a "mature economy" and the evils of "technocracy" which had developed an ability to produce beyond our apparent capacity to consume. The situation was one of widespread unemployment, idle plants, and surplus goods. This situation continued in spite of all manner of pump-priming devices until the impact of the second World War broke the dam of stagnation in which we had been wallowing and released the powerful stream of American initiative and ambition which has brought us to our present level.

Let us look for a moment at some comparative figures. In 1939 as the war in Europe was starting but before we became heavily involved, we had a national income of $72.8 billion compared with $324 billion last year. Part of this increase was certainly the result of inflation, but part was due to an increased labor force, greatly reduced unemployment, and a rise of productivity averaging, roughly, 3 per cent a year. This increased productivity released man-power from existing jobs and provided the labor for the production of the new goods and services that are constantly being developed. At the same time, it provided increased earning power to support the purchase of this new production.

In 1939, unemployment was high, amounting to about 17 per cent of the labor force. Per capita income and consumer buying power were low and prices generally were depressed. From 1940 through 1951 war, post-war and Korean demands were pressing capacity to the limit or beyond and the resulting pressure inevitably resulted in inflationary price rises. Then came another change. From early '52 until late '55, we were in a period of relative economic stability, with unemployment consistently under 5 per cent, disposable income high, production generally in balance with demand, and a reasonably stable level of consumer prices.

But in mid-1955 the situation began to change. High level income, exuberant optimism, and easier credit spurred consumer demand. Recently, in many industries demand has been pressing or even exceeding capacity and plans for industrial expansion have been accelerated faster than production could be expanded. Thus, with a high consumer demand, coupled with a growing demand for materials for plant and equipment, both pressing against a

current capacity, we may be faced with a choice between two courses, neither of which would be universally popular. One leads to another round of price increases, over-expansion, and possibly ultimate deflation. This course means more inflationary spending at the very time when we need to be encouraging savings to pay for this added capital investment. The other course is that of holding expenditures to a level which will permit a prudent expansion of production facilities while still meeting the essential needs for current consumption. This course should be familiar to any farm group for the farmer has always recognized the necessity of holding back a part of this year's crop for future replacement or expansion.

Just a few years ago we saw the folly of diverting too much of the crop from consumption to expansion. In the face of a booming demand for beef, cattlemen decided to expand, new men went into the business and both groups built or enlarged their herds at the expense of current consumption. For a time this looked like good business. The consumption demand remained strong and the urge to expand to meet that demand fed the shortage and boosted prices higher and higher. Eventually, drought and other factors caused a cessation of this expansionary trend. Then, as the production from these new and enlarged herds began to hit the market, we found we had outrun effective consumptive demand and cattle prices dropped nearly 50 per cent in three years' time.

It is this sort of a situation that must be guarded against in our industrial economy at the present time. In wartime, this can be done through rationing or allocation of materials but such a harness of controls is foreign to our concept of free enterprise and we do not accept it in peacetime.

The principal tool available and compatible with our concept of free enterprise is that of regulating the cost and availability of credit. This is the purpose of the Federal Reserve System -- to provide a flexible credit and monetary supply that will meet the needs of a growing economy while contributing to a relatively stable value for the dollar; i.e., a minimum fluctuation of the price level. It has been with this objective in mind that the System has followed a policy of varying degrees of restraint as inflationary pressures have manifested themselves over the past year. This restraint is applied to the total available supply of credit and, as such, its effects are felt throughout all segments of the economy. Naturally, its success is dependent upon many factors, including the fiscal policy of government and the wise and prudent allocation of available credit by individual lenders throughout the country.

The farmer is inevitably interested in this general situation. His future depends upon a sustainable growth, a high consumer purchasing power and a balance of production to effective demand. Any over-expansion leads temporarily to inflation and ultimately to deflation. The experience of agriculture in the past few years is an all too painful example of this situation.

And now let us look more specifically at the farmer's share in this economy. In 1939, a net income of $5.2 billion to persons on farms from farming amounted to approximately 7.4 per cent of the national total while in 1955 a net income of $13.4 billion amounted to only 4.5 per cent of the total. At the same time, however, farm employment dropped from 9.6 million, or 21 per cent of total civilian employment, in '39 to only 6.7 million or 10.6 per cent

in 1955, with the result that the per capita share of national income received by farmers increased over this total period in spite of the drop in the last five years.

In looking at the importance of agriculture in the total economy, the question is frequently raised as to the significance of the increased cost of production in terms of farm purchases of equipment, fuel, agricultural chemicals, etc. While it is true that off-farm production expenditures have more than trebled during the past 16 years, they have actually shrunk from about 5.3 per cent of total income in 1939 to 4.2 per cent in 1955.

I mention these figures not to belittle the importance of agriculture but to point up an element of change that is inevitable in an expanding economy. Certainly, agriculture, as the principal source of our food and clothing, is and for the foreseeable future must continue to be our most basic industry. While many of the luxuries of the past have come to be considered as necessities today, we have lived without them and we could again, inconvenient as it might be. In fact, a large part of the world is living without them today.

However, important as food is, the amount that we can consume is limited. In fact, as the developments of machine power replace the need for human energy, our food needs actually decrease. This means that, once we have attained a satisfactory plane of nutrition, any increased demand for food is dependent solely on population increase. Fortunately, most of our people have enough food. In fact, many of us have too much as witness the widespread "battle of the bulge" and the doctors' admonitions against overweight. True, many of our people, both rich and poor, need an improved quality of diet but

few need or want any larger quantity of food. Once his stomach is filled, man is not interested in more food regardless of the price or the amount of money he has.

This is not true of most of the other segments of our economy. Man's desire for other things is limited solely by his imagination and his ability to pay. Out of his imagination he has conceived and developed everything from the most primitive shelter and tools of the past to the most recent achievements of science and industry both in terms of tools of production and of goods and services for his use and enjoyment. And through increased productive efficiency he has released man-power from existing jobs to produce these new fruits of his imagination and ingenuity at the same time that he has increased his purchasing power to pay for them.

I mentioned earlier this tremendous increase in industrial efficiency which has averaged approximately 3 per cent a year for the past 15 years. The increase in agricultural productivity has been even greater, averaging approximately 6 per cent a year over the same period. Unfortunately for agriculture, its increased productivity has outrun our domestic capacity to consume and this condition has not been adequately offset either by increased outlets through foreign markets or new uses.

During the 30's agriculture was depressed largely because of the depressed condition of the rest of the economy. The deflation, which followed the economic collapse of the late 20's, resulted in unemployment and loss of buying power that crippled the market for agricultural products. Urban unemployment retarded and in some cases reversed the normal flow of excess farm labor to industry, thus increasing the employment problem on the farm. At the

same time, the loss of urban buying power resulted in the accumulation of farm surpluses, the further depression of farm prices, and a reduction of farm buying power for industrial commodities. It was a vicious circle in which it was often difficult to say which was cause and which was effect.

This, coupled with the lower flexibility of industrial prices compared with farm prices, led to a wide disparity of farm purchasing power. The development of the parity price concept and measures to implement it grew out of this situation but little progress was made in correcting price relationships until after the outbreak of World War II. War demands stimulated prices and created man-power shortages, which were felt most acutely on the farm. It was no longer a question of what to do with surplus farm labor and surplus commodities but rather one of how to produce what we and the world needed with the labor and facilities available.

As a result, agriculture advanced technologically during the past 15 years at a rate about double that of the rest of the economy. Unfortunately, the continuation of production incentives, after war and postwar needs had abated, retarded prompt adjustment to a peacetime basis, and since the Korean episode agricultural income has declined as farm surpluses mounted.

There is a marked difference, however, in the present situation from that in the 30's. Then we had loss of confidence, business and industrial stagnation, burdensome unemployment, and lack of consumer buying power. Today we have the reverse. Practically all phases of business and industry are at record or near record levels. Employment is high and consumer purchasing power is at record level. In some areas there is an actual shortage of essential industrial commodities.

Here, then, is our dilemma. On the one hand, business and industry are booming, wages and prices are increasing, and inflation continues to manifest itself. On the other hand, agriculture is still caught in the throes of over-production and deflation although the change in trend in recent months seems to indicate a definite improvement in that situation.

For the economy as a whole, a cautious restraint of inflationary tendencies would seem to be in order. Certainly, inflation would be of no help to the farmer. Since his price problem is definitely one of surplus supply rather than lack of consumer buying power, inflation would be of little help to him in terms of increased selling price, especially for commodities that are in surplus, and it would definitely be a detriment in terms of increased prices on the things he has to buy both for production and for his own use. Neither would inflation help the large and growing group of our population who are dependent on fixed incomes, whether salaries, pensions or annuities, and on insurance protection for their families. To ride that fine line of restraint needed to avoid inflation without bringing the growth of the economy to a halt is like riding a skittish horse. It calls for a taut and steady rein that can check any bolt, at the same time avoiding any jerks that might bring him to a sudden halt and catapult the rider into the ditch.

Difficult as this job is, the farm problem is more complicated and can be remedied only over a period of time. There are several facets to the problem and, while most of them are familiar to all of you, I would like to call your special attention to a few of them.

First, we must give greater attention to the wise conservation and use of our land and water resources. We have thousands of acres in cultivation that are so low in fertility, so subject to water or wind erosion, and so subject to drought as to be unsuited for cultivation except under abnormally favorable conditions of weather and price. Much of this land would be more productive and a better conservator of our dwindling water supply if it were restored to its natural cover of grass and trees. If this land were taken out of cultivation, it would do much to enable the operators of our productive crop lands to utilize their lands to the best advantage without the handicap or necessity of acreage allotments. In this connection, I was interested to hear a State Forester of a Southern State say recently that his orders for seedlings for reforestation this year were double the capacity of the State nurseries to supply.

Second, we must give more attention to the development of increased outlets for our farm production. This may mean increased foreign outlets through improved trade relations and more realistic pricing. It may mean the development of new uses or better quality for existing uses. Here again we should not lose sight of the tremendous increase in the present and potential use of wood products as a need for reforestation of many of our less productive crop lands. It may also mean curtailment in production of some of the starchy foods and increased production of meat, milk and poultry products, which are so essential to improvement in the quality of the diet for our constantly growing population. Here we should remember two things: (1) increased per capita consumption of these products offers a tremendous potential outlet for increased production; (2) production of animal products requires about

six times as much land per unit of human food produced as do our surplus grains; hence, the diversion of less productive crop land to pasture would serve both to conserve the land and to reduce our crop surpluses.

Third, we must continue to advance in productive efficiency. The advancement of our whole economy is based on that philosophy. There is no more future for the inefficient or inadequately equipped farm than there is for the inefficient merchant or manufacturer. The modern farm must be adequately equipped and operated by the best known methods. We can no more expect to keep up in the race of farming today with the tools and methods of yesterday than we could in procession on the highway with a Model-T or a team of mules. By this, I don't mean that we should resort to the rules of some of our modern turnpikes where they fine you or rule you off the road as an impediment to traffic if you go too slowly. Rather, we should exert every effort in assisting the man on an inefficient unit to increase and modernize his operations to an efficient level or, if that can't be done, we should assist him in finding other opportunity for the more profitable employment of his time and ability. This includes providing more opportunity for industrial employment and more training for him and his children for such employment. It also calls for a broader understanding of the importance of mobility of labor and alternative opportunity in this ever-changing and expanding economy of ours.

In this connection, it is most encouraging to see the industrial development in many sections of the South. This increased opportunity for industrial employment has resulted in two changes in the farm picture. In some cases it has resulted in reorganization of the farm operations so as to

permit part-time, off-farm employment, thus raising the family income while maintaining a farm home. In others, it has resulted in a family moving into full-time, off-farm employment, thus permitting two or more inadequate farm units to be combined into efficient family-size farms.

Fourth, we must realize that farming is a way of making a living as well as a way of life. Unless it provides an adequate living, it will not be a very attractive way of life. In other words, it is a business and must be run as such. The size of the average family farm has increased 40 per cent and the average capital investment is four times the amount required in 1940. This means that the farmer is increasingly dependent on larger and larger amounts of credit. To be able to justify and secure this needed credit, he must have a plan of operation and a prospect of income that will provide for the orderly retirement of this debt over a reasonable period of time. Adequacy of collateral is not sufficient justification for the extension of credit. Unless the operation gives promise of being profitable to both borrower and lender, it is of doubtful value to either party or to the community. Unfortunately, there are cases where too much credit has been extended on unsound operations that only resulted in the gradual attrition of the borrower's assets and his ultimate failure. So that farmers may be better acquainted with the increasing importance of sound business planning, your Extension Service has inaugurated the Farm and Home Development Program. In this program farmers are assisted in analyzing their farm operations and developing a farm plan that will support and justify their requests for necessary credit. And lenders will normally accommodate such requests even in periods of credit restraint when credit for less promising or more speculative requests may be denied.

On this basis we can do much to strengthen our agricultural economy at the same time that we exercise a prudent restraint on credit expansion in the interest of a sound, sustainable growth for the entire economy. I would not close, however, without warning you that neither the Federal Reserve System nor any combination of governmental agencies can assure that we will have a straight line growth in our economy. It is in the nature of life itself that we have periods of accelerated activity followed by breathing spells or periods of decelerated activity, and the best we can hope to do is to moderate the magnitude of these fluctuations in the light of our best information and judgment at the time.

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